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Monthly Letter on
Economic Conditions
Government Finance

New York, September, 1948

General Business Conditions

THE attention of the country has continued to be centered on prices, which way they are going, whether anything should be done about them and if so, what? On all these questions opinions differ widely. Commodity prices are higher on the average than at the peak in 1920. The cost of living is oppressive, people are eager for relief, and the situation is made to order for dispute as to where the blame belongs and how relief can be found. Business men are uneasy about the boom and fearful that the longer it runs the greater will be the reaction.

At the same time, the will to deal forcefully with the inflation problem is qualified by other considerations. One is the fact that high prices are only the other side of high incomes and cannot be knocked down without affecting incomes. Some people give little thought to this aspect or, if they do, seem to believe that other people's prices can be put down while their own incomes are maintained. But when detailed proposals are offered those affected on the income side are sure to be heard from.

Another qualifying influence is the fear that overly vigorous action might take effect just as the situation was ready to turn of itself. Many people are impressed by indications in farm products and some other markets that the inflation may be at the halting point. They think the pressures are abating, that out-of-line prices will work themselves down naturally, and that strong repressive measures might work too well and start the economy spinning into a spiral of liquidation, losses and unemployment.

The Special Session

All these influences and others, political as well as economic, were reflected in the special session of Congress. The recommendations of the President, as described in this Letter last month, included on the one hand proposals to try to repress inflation by more controls and more taxes, and on the other, a catch-all of conflicting and nullifying measures which, if adopted, would have increased industrial costs and added to the Government's huge spending — lending — guaranteeing activities. Even if controls were operated successfully, the President's program in total could only repress the symptoms of inflation or defer its effects, while actually building up more inflationary pressure.

Congress rejected price controls, rationing and the corporate excess profits tax as unnecessary, impracticable and positively harmful. It adopted the recommendation to permit restoration of controls over consumer credit, and it gave the Board of Governors of the Federal Reserve System power, effective until June 30, 1949, to increase member bank reserve requirements by a limited amount. On the other hand, it renewed and liberalized government guarantees of housing loans, which will encourage further expansion of urban mortgage loans. Many people consider real estate

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loans the most influential single factor in the inflation.

The new powers affecting credit can add nothing to the supply of goods, and while they are designed to reduce demand by limiting the ability of people to borrow and banks to lend, their effect in the overall situation is not likely to be very great. Consumer credit has expanded since the end of the war not primarily because instalment terms have been eased – in fact, the fixed terms prescribed by the Federal Reserve Board's Regulation W were in effect until November 1947 – but because the items sold on deferred payment became increasingly available, because needs were acute, and because people, having jobs and owning liquid assets, could command credit. In most cases these influences toward expansion are still present. The trend seems unlikely to be reversed by stiffening terms on payments, although it may be slowed down and inflationary pressures to that extent abated.

The power to increase member bank reserve requirements, which is discussed on a later page, is also but one of many elements in the credit outlook, and far from the most important one. As a means of dealing with credit inflation it is hardly more than a gesture, while in some respects its effects may be undesirable.

In summary, the special session added to, rather than subtracted from, government spending – lending – guaranteeing; it encouraged a further growth in mortgage credit; and it adopted two credit control measures which cannot be expected to do much as long as other policies of the Administration favor credit expansion. This is not getting at the causes of inflation.

Phenomenal Crop Prospects

While the headlines were giving prominence to the special session, a check to the rise of prices was occurring elsewhere. The passage of another month of good weather has confirmed and strengthened the phenomenal crop prospects. It is now almost certain that the yield of feed grains will break all records by a wide margin; the supply per animal unit over the next twelve months will be 25 per cent larger than in 1947-8 and much the largest on record. Moreover, the wheat harvest is second only to that of 1947, and the cotton crop will be among the larger ones of our history with the highest yield per acre ever made. It is safe to say that the crop yields will hold down prices over the next year more effectively, and deal with the inflation problem more fundamentally, than anything proposed by the President or enacted by Congress. Declines in grains and cotton brought the farm products group of the official wholesale price index down 3.9 per cent in four weeks ended August 14, even though livestock was strong throughout the period.

This change of trend in farm prices is the most significant development in the economic situation. It has already put wheat, cotton, and futures prices for corn down to the government loan levels or lower. Consumers, seeing livestock and meat selling at all-time record prices during the month, wonder when the cost of living will drop and are discouraged by predictions from the Department of Agriculture and elsewhere that major easing in retail food prices is not to be expected for another twelve months or so. The reason, of course, is that time is required to increase animal numbers and feed them to heavier weights. The number of hogs to come to market next winter was determined by the number farrowed last spring, and although hogs promise to be highly profitable relative to corn for a considerable time to come, the inducement to increase hog numbers cannot become fully effective until the pig crop of next spring, for slaughter in the fall of 1949. The cattle cycle is longer.

Nevertheless, more and cheaper feed may have earlier effects in some directions. Butter has declined, partly because there will be more cottonseed oil and soybean oil to make margarine. The first improvement in meat supplies will be in broilers, a matter of 60 to 90 days. In July baby chick hatchings were 16 per cent higher than a year ago, and the August increase was undoubtedly larger, since 46 per cent more eggs were in incubators August 1. When these broilers come to market supplies of hogs and grass-fed cattle will also be increasing seasonally. Meantime, producers of all animals and meats are on notice that the long-term trend of prices is downward. Except as seasonal considerations govern, the inducement to store products for higher prices has disappeared. Even feeders, holding animals to consume cheap feed and put on more weight, will know that the market trend basically is against them.

Are Prices Stabilizing?

In reviewing the work of Congress in the special session, Senator Taft said, "There are many reasons to believe that we are reaching a stabilized price level." In the long run the influence of cheaper farm products will work through the price structure. When it is finally reflected in living costs it will cut the ground from under the main argument used for the second and third round wage increases, and leave little to support

demands for a fourth round. The prospect for halting the rise in industrial costs and prices is improved accordingly.

At the same time prices of some manufactured goods have weakened because supply has caught up with demand and filled up the void in inventories that existed for so long. Various cotton goods constructions, apparel items and shoes are examples. As the catching up spreads the price rises will halt because the markets will not stand them. Sales of seven electrical appliances, out of eighteen for which figures are compiled, declined in the first five months of this year as compared with 1947.

For both these reasons the possibility that the long price advance may be levelling off at last is impressing itself increasingly on business sentiment and on business decisions. This is a prudent and reasonable view. Nevertheless, complacence should be avoided. The course of prices will be influenced not only by the crops but by what people and the Government do. As long as the Government spends, lends and guarantees on the present enormous scale, and as long as it keeps the doors to credit open as wide as they are, the inflationary forces will persist. The Government is committed to the European Recovery Program. It is committed to increased defense expenditures. Both are inflationary in their effects. Both should be operated without waste, and their necessary cost should be offset by economy elsewhere.

The fear that business may be on the point of a major downturn, and that stronger anti-inflationary measures might push it into a depression spiral, seems to misinterpret the effect of lower farm prices, and otherwise finds as yet little substantiation. The price softening is concentrated in areas where the rise had been greatest, and where readjustment will benefit more people than it hurts. Farmers will have more to sell, and will have a correspondingly good income even at lower prices. The signs of readjustment are spotty, not general. Deferred demand is far from exhausted in many lines, including the metals, automobiles and many types of capital equipment, and the position in all those lines is still immensely strong. People and business are far less extended financially than at previous times when booms have given way to depressions. The supporting factors are powerful, and the idea that lower farm prices may initiate a business decline hardly seems to take sufficient account of the fact that declines in these prices are limited by government supports, and inflation to that extent is kept active.

Curbs on Credit

The two points on the President's anti-inflation program that the extra session of Congress enacted into law both related to credit and in both cases the new emergency powers go to the Board of Governors of the Federal Reserve System. A Joint Resolution passed by the Congress, and approved by the President August 16, permits the reimposition of Reserve Board regulation over consumer instalment credit. It also authorizes the Reserve Board to increase the reserve requirements of member banks of the Federal Reserve System four points on demand deposits and one and one-half points on time deposits. The new powers expire June 30, 1949 by which time the new Congress will have had a chance to survey developments and make a determination of policy. A third proposal, which would have raised the gold reserve requirements of the Federal Reserve Banks to the pre-1945 level, passed the House of Representatives but was later dropped.

With the need for anti-inflationary action pointed up in the Congressional hearings, the administration and the Federal Reserve made use of their already existing powers to make short-term credits a little more costly and harder to get. On August 9, two days after the adjournment of Congress, the Treasury announced a rise of one-eighth of one per cent in the rate paid on one-year certificates of indebtedness, the first change in this rate since January. The new rate of 1¼ per cent will apply to one-year certificates to be offered in exchange for $6,913 million of certificates and notes falling due October 1. The Treasury also disclosed that holders of $3,748 million 1½ per cent Treasury notes coming due September 15 would receive the option of exchanging them for a new issue of 1⅜ per cent notes coming due April 1, 1950. A September 15 maturity of $451 million partially tax-exempt 2½ per cent bonds will be paid off from surplus cash.

The Federal Reserve authorities promptly acted to reduce their supporting bids for Treasury bills, certificates, and notes, became sellers of these securities, and followed up with a rise in discount rate from 1¼ to 1½ per cent.

Under its new authority, the Federal Reserve Board issued instalment credit regulations which will go into effect September 20. In the following table the new terms are compared to those in effect prior to November, 1947, when the wartime control was terminated, and also standards which have been used as a guide by members of the American Bankers Association since then. Of the total consumer credit outstanding, recently estimated by the Reserve Board at $14 billion,

the new regulations apply to perhaps one-half. Charge account credits and single payment loans are not made subject to regulation.

Consumer Instalment Credit Terms

	Regulation W terminated 11/1/47	ABA Guide	New Reg. W effective 9/20/48
Maximum credit covered	$2,000	$2,500	$5,000
Autos			
Down payment			
New cars	33 1/3%	33 1/3%	33 1/3%*
Used cars, '46 and later	33 1/3%*	33 1/3%	
" ", '40-'41.'42	33 1/3%*	40%	
Maximum maturity			
New cars	15 mos.	24 mos.	15-18 mos**
Used cars, '46 and later		18 mos.	
" ", '40-'41.'42		15 mos.	
Household appliances			
Down payment			
Refrigerators, ranges, washers, ironers	33 1/3%	20%	20%
Radios, phonographs, other appliances		25%	
Maximum maturity			
Refrigerators, ranges, washers, ironers	15 mos.	36 mos.	15-18 mos.**
Radios, phonographs, other appliances		18 mos.	
Furniture and furnishings			
Down payment	20%	—	20%
Maximum maturity	15 mos.	—	15-18 mos.**
Instalment loans			
Maximum maturity	15 mos.	—	15-18 mos.**

*Maximum loan value 66 2/3% based on the cash price or on an officially approved "appraisal guide value", whichever is lower.

**Limit of 15 months on loans of $1,000 or less, and of 18 months on loans over $1,000.

Effects of Higher Short-Term Rates

The shift of the Treasury to a 1¼ per cent rate on its one-year borrowings, together with the rise in the Federal Reserve discount rate, represent a continuation, after a lapse, of the "modest" policy of credit restraint carried through last fall and winter. The general effect of these latest moves is to make access to Federal Reserve credit more expensive — to the banks on their borrowings from the Federal Reserve, and to all holders of short-dated government securities who wish to convert them into cash before maturity. It also makes short-term governments, at their lowered prices, a little more attractive for purchase by investors with idle funds.

Banks reviewed their lending terms and open market money rates were adjusted in line with the higher rate on Treasury certificates and the advanced Federal Reserve discount rates, as the following table indicates:

Open Market Interest Rates

	June 30, 1947	Jan. 31, 1948	July 31, 1948	Aug. 31, 1948
3 months Treasury bills	0.375%	0.99%	1.00%	1.08%
9-12 months Treasury certificates	0.85	1.10	1.10	1.17
Prime bankers' acceptances, 90 days	⅞	1 ⅛	1 ⅛	1 ¼
Prime commercial paper, 4-6 months	1	1 ⅜	1 ⅜	1 ½

The rise in interest rates was limited to the shorter-term market. The Federal Reserve Banks held fast to their support levels for the War Loan 2¼ and 2½ per cents and thus effectively forestalled any general reaction in bond prices and any general advance in the cost of long-term borrowings to business, builders, and State and local governments. Thus these latest moves are of a gentler variety than those of last winter when a lowering of support levels for long-term Treasury bonds, as well as for the short-term Treasury obligations, influenced the cost and availability of credit straight across the board.

The Bond Price Support Program

The maintenance of the pegs for longer-term government bonds involved continuing substantial purchases by the Federal Reserve Banks. Purchases during the four weeks ended August 25, totalling $1,008 million, bring the support since June 23 up to $1,387 million, as shown below:

Federal Reserve Operations in Government Security Market
(In Millions of Dollars)

	Dec. 31, 1947 to March 24, 1948	March 24 to June 23	June 23 to Aug. 25
Market transactions in—			
Bonds over 5 years to maturity	+2,643	— 46	+1,387
Bills, certificates, notes and shorter term bonds	—1,027	+836	— 137
Redemptions by Treasury	—3,568	—387	— 800
Net change in portfolio	—1,952	+403	+ 450

Support of the bond market in this latest phase — since June 23 — has been concentrated on the War Loan drive 2¼ and 2½ per cents, issues which commercial banks are not eligible to buy. The selling has originated with insurance companies, mutual savings banks, savings and loan associations, and other "nonbank" lenders who are using this means of increasing their lending power. The price pegs offer the nonbank lender an inducement to sell out the War Loans in favor of other lending or investing opportunities. On two of the ten bank restricted issues the nonbank lender can get out at par; on the other eight issues the Federal Reserve pays a premium — running up to one and one-quarter points — over the original purchase price. In short, the pegs as established *invite* selling and, with the record-shattering demands for funds, it is not surprising that the invitation is being accepted. The upshot is an undoing of the work of the War Loan drive committees during the war in placing as much of the public debt as possible outside the banking system. The commercial banks were forbidden to buy these securities, except for limited purchases for their savings departments. Now, from all the evidence, the Reserve Banks are buying

them up and in so doing creating problems of credit expansion which the Reserve officials themselves view with misgivings.

As the table shows, redemptions of Treasury bills held by the Federal Reserve Banks, at a rate of $100 million a week since July 1, have offset a part of the Federal Reserve's purchases of long-terms. The recent rise in yields on Treasury bills and certificates has helped the authorities distribute in the open market some of their holdings of short-terms. Also, the Federal Reserve has withdrawn fixed supports from bonds held mainly by commercial banks.

Nevertheless, the unmistakable tendency has been for the Federal Reserve's total portfolio of government securities to rise. This is a tendency which, in the circumstances, is undesirable and unhealthful. The crux of the problem obviously lies in the peg levels for the War Loan 2¼ and 2½ per cents. There are two direct ways out of this dilemma. One would be to place restrictions on sales. The other would be to allow the price to decline below par so that a holder of the War Loans would suffer some loss if he sold out prior to maturity. The first solution is that of a controlled economy. The second is that of a price economy.

The Reserve Requirements Question

The problem of how to keep government bond prices at arbitrarily fixed values, and at the same time curb tendencies toward excessive credit expansion, was constantly in the background during the brief hearings before the Congressional Banking and Currency Committees on the President's proposal to increase reserve requirements of member banks of the Federal Reserve System. Indeed, the stated reason for authorizing increases in the reserve requirements at this time was "to enable the Federal Reserve System to acquire more – if necessary many more – long-term government securities to maintain the long-term yield level." In this way, Chairman McCabe of the Federal Reserve Board stated, "new reserves created by such System purchases could be absorbed through increases in reserve requirements and thus be unavailable for multiple credit expansion."

By this "solution" the Federal Reserve presumably would continue to inflate their government bond holdings without predetermined limit, and in so doing facilitate increased lending by nonbank lenders. The reaction of the practical banker – if one had been called upon to testify – might well have been: "Why crack down on us so that our competitors can take the business?" And it is true that, under prevailing conditions, where an insurance company has as ready access to Federal Reserve credit as any bank, it makes little practical difference, from the standpoint of inflationary credit expansion, whether a given loan is granted by a commercial bank or by some other type of lending agency.

Equally important inconsistencies of policy became apparent in the discussion of bank lending volumes. It was brought out that the bank loan classification showing the major increase this year was mortgage loans, backed by government guarantees. And one of the principal purposes for which the Congress had been convened was further to enlarge, not to reduce, the amount of money and credit available for building.

The Risks

Higher member bank reserve requirements not only would conflict with the government policy of easy mortgage credit and cheap borrowing rates for the Government itself, but also would involve risks of shutting off credits for essential business purposes. In a letter to the chairmen of the Banking and Currency Committees, Joseph M. Dodge, President of the American Bankers Association, stated:

> Credit has two aspects. One relates to consumption, and the other to production. The use of credit follows prices and business volume. Someone has to ask for credit before it is granted. Its use is based on the need for it. If business activity is to be continued at the present volume and at present high price levels, there will be a continuing need for a correspondingly large use of credit.
>
> We must be careful not to contribute to an economic reversal so freely prophesied and wished for by the Soviets. We must be sure that the cure proposed does not bring a reaction worse than the disease. Credit on a national basis is a delicate mechanism. Rude handling can produce disastrous chain reactions.

The problem is to find the right middle road, putting the proper degree of pressure on lenders without precipitating an undesired curtailment of production and employment. In this respect, increasing reserve requirements is a blunt instrument, a blunderbuss that hits member banks and borrowers from member banks but leaves other credit channels wide open.

Appreciation of these risks and inequities, together with the fact that no one seemed anxious to take the responsibility for a general crackdown on credit, doubtless explained the decision to permit increases in member bank reserve requirements of 4 points and 1½ points, on demand and time deposits, respectively, instead of 10 and 4 points as the President had suggested. Even the figures adopted, if put into effect, would re-

quire a conversion of at least \$3½ billion of bank earning assets into idle cash.

Effects Nullified by Federal Reserve?

From quite another standpoint, some students of the money market have minimized the effectiveness of increases in reserve requirements under the assumption that the Federal Reserve Banks would simply take over the necessary amount of government securities from the banks, and thus nullify the effectiveness of their action.

The two-point advances in reserve requirements of the New York and Chicago banks, in February and again in June, worked out in very much this way. The banks put government securities on the market to raise additional cash; the Federal Reserve Banks bought them. The upshot was a vast churning around of funds to little evident purpose.

It is difficult to tighten up credit if the authorities undo with one hand what they set out to accomplish with the other. Nevertheless, even if the Federal Reserve freely buys all government securities offered, increases in reserve requirements can have vital, "unplanned" effects. They can impose serious hardships on particular localities where the banks have been faced with heavy loan demands, do not have enough government securities left, and have little other recourse than to cut down their loans in order to raise idle cash to place on deposit with the Federal Reserve Banks.

At the same time, there is a risk that forced liquidation of government bonds by the banks may cause contagious unsettlement in the government security market, with entirely unpredictable effects. As President Sproul of the New York Federal Reserve bank testified:

> So long as we continue to give our support to the Government security market, the initiative will remain with the commercial banks and the market through the banks, as to whether they will make use of more reserve credit or not. To be sure, to the extent that the authority is used, the ratio of expansion of member bank credit based on a given volume of reserve bank credit will be reduced somewhat, and the possibility of its use will introduce another factor of uncertainty and doubt into the situation. But these gains may well be at the expense of an extended period of further unsettlement in the Government security market, involving our support and a consequent increase of the credit base, and at the expense of public confidence in the Federal Reserve System or in the sincere desire of the Government to do something about inflation. Giving the Federal Reserve System additional power to increase reserve requirements isn't going to bring down the price of meat or the cost of housing.

Federal Reserve Bank Reserve Requirements

On a third proposal, to restore the old and higher reserve requirements for the Federal Reserve Banks, no action was taken. This was understandable since there had been little advance discussion of it.

The proposal to apply higher reserve requirements to the Federal Reserve Banks, as well as to member banks, originated in Congress. It had the evident purposes of reminding the Federal Reserve authorities of the inflationary potentialities in their own operations, and of shifting some of the emphasis of Federal Reserve policy from protection of the bond market to protection of the purchasing power of the dollar. Without resort by the Federal Reserve Board to its power to suspend the reserve requirements of the Federal Reserve Banks, and on the basis of the current gold reserve, the Federal Reserve System has a potential capacity to inflate its government security holdings to \$67 billion. This is more than three times the present \$21½ billion, and \$43 billion above the peak holdings of \$24 billion at the end of 1945. If the required gold cover, now 25 per cent of combined note and deposit liabilities, were restored to the 1914-45 figures of 35 per cent against deposits and 40 per cent against notes, the calculated ceiling on Federal Reserve holdings of government securities would be brought down to \$36½ billion. This would still allow a margin of \$15 billion for additions to the current portfolio, and a margin of \$12½ billion over the 1945 peak holdings.

It is thus quite clear that the restoration of the former percentages would not interfere with the current policy of pegging the prices of government bonds. Nevertheless, proponents of the proposal felt that there was something to be gained by calling attention to the reserve requirement and credit policies of the Reserve Banks and Board which lie at the very base of the credit pyramid.

Conclusions

The Congress did not find, if anyone had hoped that it would, any new patent remedies for inflation, any easy out from the dilemma of wanting cheap money and dear money at one and the same time. Expressions of confidence in the efficacy of the legislative measures taken were notable for their absence. The clearest gain was in the decision of the Treasury and Federal Reserve authorities, once Congress had adjourned,to draw on their existing arsenal of powers to bring pressure to bear on the cost and availability of short-term credits. One has only to look back to the vigorous effect on the whole credit situation last winter, when the Reserve System lowered its support levels for government

securities and raised the discount rate, for a demonstration of the effectiveness of powers now held even when sparingly used. The tools are there for exerting an orderly restraint on credit expansion.

The Revised Budget

Shortly after the adjournment of Congress, the President released the August budget review, forecasting an "operating deficit" of $1.5 billion during the current fiscal year which ends June 30, 1949, contrasted with the $4.8 billion surplus which he had predicted for this year in his original budget estimates last January. This radical change the President attributed to the individual income tax reduction, referred to as "obviously a grave error," and to increased outlays on national defense, veterans' benefits, mortgage purchases, and tax refunds.

Congressional leaders immediately accused the President of juggling the figures to suit his own political ends, stating that the revenues were underestimated while expenditures were overstated. The surplus as foreseen by some of the Congressional leaders might run to as much as $6 billion. This is a controversy which will not be finally resolved until final results are in, ten months hence, when the fiscal year comes to a close.

The difference between the President's $1.5 billion "operating deficit" and Congressional leaders' $6 billion budget surplus, arises, as indicated in the following table, not only from the differences in estimated receipts and expenditures, but also from the treatment of the Foreign Economic Cooperation Trust Fund set up by Congress under the legislation authorizing the European Recovery Program. By this legislation, the first $3 billion of expenditures under the program in fiscal 1949 is to be met out of the trust fund, which in turn was charged against the abnormally large surplus of fiscal 1948. Giving effect to this charge back, the President's "operating deficit" in 1949 therefore becomes a surplus of $1.5 billion.

Comparison of U. S. Budget Estimates for Fiscal Year 1949
(In Billions of Dollars)

	President Truman			Senators Bridges & Milliken
	Cash Basis*	Operating budget basis	Adjusted budget basis	Adjusted budget basis
Net receipts	$44.1	$40.7	$40.7	$44.0
Expenditures	42.7	42.2	39.2	38.0
Surplus or deficit	+1.4	—1.5	+1.5	+6.0

*Including trust accounts as well as budget accounts.

The President's estimate of revenues on a "cash basis" is some $3 billion higher than that on an "adjusted budget basis" because of the inclusion of social security trust funds receipts which are excluded from ordinary budget receipts. The higher figure for expenditures on a "cash basis" is explained by the inclusion of trust fund expenditures, primarily the $3 billion from the Foreign Economic Cooperation Trust Fund. Thus the overall totals, on a "cash basis", indicate the actual flow of cash receipts from and payments to the public and are generally used as a measure of the "inflationary" or "deflationary" influence of the Federal government's financial operations. If the President's budget figures prove to underestimate receipts and to overestimate expenditures, the overall surplus on a "cash basis" would be increased correspondingly over the $1.4 billion he projects as the cash surplus.

Spending Up $6 Billion

From the accompanying summary, taken from the President's August budget review and giving expenditures by major functions, it will be seen that, excluding the $3 billion adjustment for European aid, the 1949 expenditures are now estimated at $2.6 billion above the January estimates, and $6.1 billion above the actual total in fiscal 1948.

The largest increase over the January estimate is for national defense, which is up $1.1 billion to a total of $12.1 billion. This represents a sharp increase in procurement of aircraft, together with increased outlays for pay and maintenance of personnel, purchase of ordnance and other equipment and supplies, and stockpiling of strategic materials. The revised estimates allow for the cost of the draft now under way, but $500 million included in the January estimates for universal military training has been eliminated since that program was not enacted.

U. S. Budget Receipts and Expenditures for Fiscal Years Ended June 30, 1948 and 1949
(In Millions of Dollars)

	1948	1949 Estimated	
	Actual	Budget Jan. 1948	Revision Aug. 1948
Total Receipts	$44,486	$44,402	$40,658
Expenditures			
National defense	10,648	11,025	12,140
International affairs, finance	4,745	7,009	7,010
Veterans' services, benefits	6,568	6,102	6,791
Interest on public debt	5,211	5,250	5,300
Tax refunds	2,309	1,990	2,789
Social welfare	1,946	2,027	2,009
Transportation and communication	1,269	1,646	1,835
Natural resources	1,095	1,625	1,586
General government	1,390	1,157	1,187
Agriculture	687	888	868
Housing facilities	96	38	327
Labor	97	116	98
Education, general research	73	387	86
Finance, commerce, industry	95	185	77
Reserve for contingencies	—	200	100
Adjustment to daily statement	—158	—	—
Subtotal	36,066	39,594	42,208
Adjustment for Foreign Economic Cooperation Trust Fund	+3,000	—	—3,000
Total expenditures	39,066	39,594	39,208
Surplus of receipts	5,419	4,808	1,455

International affairs and finance, the next largest item in the budget, is estimated at $7 billion, the same as in January, which compares with actual expenditures of $4.7 billion in fiscal 1948. In reaching an estimate of $7 billion, the President assumes that the Congress will appropriate an additional $1½ billion before the end of the fiscal year to permit the European aid program "to go forward without interruption." The assumption heretofore has been that this program would decelerate, year by year, with the progress of European recovery. The President's assumption is that expenditures will be even larger in fiscal 1950 than in 1949. Here, of course, the new Congress will have the power of decision.

Expenditures for veterans' services and benefits are now estimated at $6.8 billion, an increase of $689 million over the January estimate. The President states that nearly four-fifths of this expenditure will be direct cash payments in the form of pensions and readjustment benefits, and that most of the increase results from new laws providing higher subsistence allowances in the educational program and more liberal allowances for on-the-job trainees, as well as from higher compensation for dependents of deceased and disabled veterans, and higher reserves for the National Service Life Insurance trust fund.

Tax refunds are figured $800 million larger than in January, primarily as a result of the easing up of the personal income tax. An estimated increase of $289 million under the classification of housing is predicated on a rough estimate of $300 million in guaranteed housing mortgages to be purchased by the Federal National Mortgage Association, a RFC subsidiary. The figures here do not reflect the vast contingent obligation the Government is accumulating by nature of its guarantees of mortgages placed with financial institutions. An increase for "Transportation and communication" reflects a larger post office deficit traceable to higher salaries and other costs.

Aids to Agriculture

A small increase for "agriculture" is labeled "tentative" and assumes that larger government outlays to support prices of farm products will be offset by larger repayments on commodity loans than were previously anticipated. Three factors contribute to the larger liability of the Government for farm price supports: the decision of Congress to extend the wartime price support formula for another year, the higher prices paid by farmers which raise the support levels automatically, and the bumper crops which have driven market prices of such important commodities as wheat, cotton, and potatoes down to a point where heavy support operations come into play.

It must be considered probable, with farm markets as they are now, that agricultural outlays will exceed the President's estimate. For example, on cotton alone, with the price now down almost to the support level of 30.74 cents per pound, there would be an outlay, if the Government had to buy one-fifth of the record 15,000,000 bale crop, of $450 million. There are similar contingent liabilities for either mandatory or permissive support of wheat, corn, rice, flaxseed, beans, peas, potatoes, soybeans, peanuts, hogs, chickens, turkeys, milk, eggs, tobacco, sugar beets, sugar cane, wool, naval stores, seeds, and practically every other agricultural crop and commodity.

The labors of the Congressional appropriations committees in cutting down government expenditures are often covered up in increases that would have been much larger if the President's full recommendations had been allowed. Actual decreases show up for education and general research, and also for finance, commerce, and industry. These reductions are largely explained by the elimination by Congress of $290 million as the original outlay for a new program of educational grants to the States, and around $100 million for administering price and rationing controls.

Taxes Over $40 Billion

Total budget receipts for fiscal 1949 were estimated by the President in January at $44.4 billion, now lowered to $40.7 billion, giving effect to the tax cut. The revenue loss as now foreseen, $3.7 billion, compares with earlier predictions that the tax cut would involve a $5 billion loss of revenues.

The continuing rise in the level of total national income and its principal components, and the correspondingly larger yields expected from corporate, excise, manufacturers', and other internal revenue levies, doubtless accounts for the view expressed by Congressional leaders that actual receipts in fiscal 1949 might reach as high as $44 billion.

Of course, no one at this time can forecast final results with close accuracy. President Truman emphasized the uncertainties of budget forecasting when he stated: "It is possible that further inflationary developments may produce higher revenues than those now estimated – revenues might even rise above expenditures. Even if this should prove true, however, it is hardly sound

fiscal policy to rely on inflation as a method of balancing the budget."

In a period of expanding business and rising prices, the budget receipts, estimated on the basis of existing national income, tend to run strongly ahead of the estimates. For example, receipts for the fiscal year 1948 were first estimated by President Truman in his budget message of January 1947 at $37.7 billion, and raised in his August 1947 revision to $41.7 billion, but actually reached $44.5 billion, in spite of the initial effects of the personal income tax reduction beginning May 1, 1948. Thus there was a discrepancy of almost $7 billion. Likewise receipts for fiscal 1947 were first estimated at $31.5 billion, but actually were $43.3 billion, a discrepancy of almost $12 billion.

Need for a Major Operation on Costs

Even though this increased national income may produce satisfactory results in terms of a budget surplus, the average citizen will agree with the President that relying on inflation to balance the budget is hardly sound fiscal policy.

The next question is, where does this leave us? Surely, the really discouraging feature of the budget is the constant swelling of expenditures, and in the fourth year after the end of the war when they ought to be getting down to size. The greatest need today is a major operation on costs, a task on which the legislator, the executive, and the people will have to work together.

Latin America's Dollar Payments Difficulties

New foreign exchange regulations by Argentina and Colombia in June, and the devaluation of the Mexican peso in July, have provided fresh evidence of Latin America's postwar balance of payment difficulties with the United States. With gold and dollar balances drawn down, payments for imported goods tending to lag, and more and more obstacles put in the way of trade, our exporters are naturally concerned. There was a sharp drop in our exports to Latin America in June, bringing them to a level nearly 30 per cent below the 1947 average.

Latin American international payments with the United States, like those of other parts of the world, have been out of balance. Demand for dollars has been outstripping the supply for a number of reasons, chief of which is the fact that this country has been practically the only source of most goods wanted by Latin American countries. Another important factor has been the greatly expanded internal purchasing power, a heritage from wartime and postwar inflation. With costs and prices in most Latin American countries rising more than in the world markets, exports have been discouraged and imports encouraged. The steps taken lately by Argentina, Colombia, and Mexico, like earlier moves by some of the other republics, are intended to conserve their dollar resources and improve their trade balances with this country.

To be sure, the situation varies greatly from country to country. Dollars continue to be quite freely available for bona fide trade transactions in Cuba, Venezuela, the Dominican Republic, Haiti, El Salvador, Guatemala, Panama, Honduras, and Uruguay. Uruguay, however, requires import permits, restricted at present largely to industrial equipment and raw materials. With the exception of Panama, the purchases here of these nine republics are still near last year's level.

It is the remaining eleven republics, which in the past two years took some two-thirds of our Latin American exports, that are in balance-of-payment difficulties. Some of them, including Chile, Ecuador, Peru, and Bolivia, have been short of dollars for nearly two years, and have had to fall back on their prewar arsenal of trade and exchange controls to bring purchases here down to the level of current dollar earnings.

Financing 1947 Purchases

In 1947 Latin America's purchases in the United States reached the unprecedented total of $3,860 million (U. S. statistics). This compared with a 1937-39 annual average of $530 million, and a 1941-45 wartime annual average of $950 million. Including some $2,000 million spent elsewhere, Latin American countries last year bought goods footing up to nearly $6 billion. Even adjusted for price changes, this figure had never before been approached.

The following table, based on the best available estimates, gives an approximate indication of how this huge trade, plus transfer of income from U. S. investments and transportation charges, was financed:

Latin America's Approximate Supply of Dollars in 1947
(In Millions of Dollars)

Sale of goods to United States (U.S. statistics)	$2,150
Draft on gold and dollar resources	800
New capital (direct investments, bank credits, etc.)	600
Receipts of dollars and convertible exchange earned in transactions with other countries	1,000
Total	$4,550
Purchases of goods in the United States	$3,860

Note: The dollars representing the difference between the overall earnings of dollars and the actual expenditures for merchandise purchased here were largely used up by other dollar-requiring transactions, such as transportation charges, transfer of earnings on U. S. investments in Latin America, royalties, etc. Probably the difference also covers some capital shifts.

The table reveals the important role played by the wartime accumulated gold and dollar resources, and by earnings of dollars and convertible exchange in Latin America's trade with countries other than the United States The balance-of-payment difficulties of the eleven Latin American republics are primarily the consequence of the drying-up of these two sources of dollars. Through their heavy spending, their own wartime earned gold and dollar resources have been nearly depleted. Then, to top this, their customers in Europe also ran out of dollars as United States credits were exhausted.

The extent to which the wartime earned gold and foreign exchange resources of these eleven countries have been used up is shown in the next table. By far the heaviest loser was Argentina; between September 1946 and June 1948, her gold and hard currency resources declined by over $900 million. Mexico and Colombia were the next on the list.

Gold and Foreign Exchange Reserves of Latin American Republics

(Expressed in Millions of Dollars)

Countries Short of Dollars	Dec. 1945	Dec. 1946	Dec. 1947	June 1948
Argentina				
Gold and dollars	$1,176	$1,055	$ 319	$ 202
Sterling & other exch. (net)	454(a)	566	719	573
Bolivia (b)	38	36	33	30(c)
Brazil				
Gold	354	354	354(f)	354(f)
Foreign exchange (net)	288	369	338	343(g)
Chile	110	69	56	50
Colombia	177	176	112	92
Costa Rica (b)	9	6	8	11(c)
Ecuador	33	37	27	25
Mexico	344	224	112	90(e)
Nicaragua	7	6	5	10(h)
Paraguay	10	11	10	11
Peru (b)	49	44	47	41(c)
Total above	3,044	2,953	2,140	1,832
Same without Argentine and Brazilian sterling and other exchange holdings	2,307	2,018	1,083	916
Other Countries				
Cuba				
Cuban Treasury	232	251	358	365
U.S. currency in circulation	249	276	303	353
Deposits abroad (gross)	98	109	187	194
Dominican Republic (i)	n.a.	43	40	38
El Salvador	28	29	29	34
Guatemala	40	46	48	47
Honduras (j)	16	16	14	14(e)
Haiti	11	12	11	10
Panama (k)	89	77	70	78(g)
Uruguay	252	291	255	267
Venezuela (l)	246	269	274	356
Total above	1,261	1,419	1,589	1,756
Grand Total	4,305	4,372	3,729	3,588
Same without Argentine and Brazilian sterling and other exchange holdings	3,568	3,437	2,672	2,672

(a) Including gold and custody certificates. (b) Including gold and foreign exchange holdings of commercial banks. (c) May 1948. (e) Partly estimated. (f) Since June 1947, $80 million has been pledged for a loan contracted from the U. S. Treasury. (g) April 1948. (h) $3.5 million pledged against the Bank of America credit of $4.5 million. (i) Including holdings of commercial banks and U. S. currency in circulation. (j) Including U. S. currency in circulation. (k) Short-term assets in the United States. (l) Including Venezuelan Treasury and commercial bank holdings.

Sources: International Financial Statistics (Int. Monetary Fund), Federal Reserve Bulletin, Foreign Commerce Weekly, Monthly Bulletin of Statistics of the United Nations, and central bank bulletins of individual countries.

Of some $1,800 million of gold and foreign exchange reserves left to the eleven republics in dollar shortage difficulties at the end of last June about one-half was inconvertible currencies, mostly pounds sterling. This left them only about $900 million in gold and dollars – not a large sum considering the volume of foreign trade involved and the great expansion of their domestic currency and deposit liabilities.

The resources of the other nine republics aggregated last June $1,756 million. Consisting chiefly of gold and dollars, this would allow for further substantial drafts on the exchange position of most of the countries concerned.

The 1948 Dollar Supplies

How does Latin America's supply of dollars in 1948 compare with the 1947 figures?

In the first place, Latin America's merchandise sales to us are creating more dollars During the first half of the year our imports were at the annual rate of $2,450 million, or $300 million more than last year. These imports were, however, weighted by the heavy purchases – since sharply diminished – of wool and hides from the River Plate countries following our tariff reductions on January 1, 1948. On the other hand, imports are likely to be bolstered up later this year by our strategic material purchases under the stockpiling and rearmament programs.

This year's total of long-term loans, direct investments, and bank credits, will again be considerable, although perhaps not reaching the exceptionally large amount of $600 million furnished in 1947. While no action was taken by Congress on President Truman's request for an increase of $500 million in the loan funds of the Export-Import Bank for suitable projects in the American republics, these countries still have some $180 million in unutilized credits with that institution. Also the International Bank, according to its president, Mr. John J. McCloy, expects to devote "a major part of its attention in the period ahead to the needs of Latin America." The beginning was made last March, with two loans to Chile in the aggregate amount of $16 million. Loan applications by other republics are being considered.

The dollars provided by drafts on the gold and dollar resources of Latin American republics, and also their earnings of convertible exchange, both of which played so important a role in their 1947 balance of payments with us, will be down sharply. The question is to what extent this decline will be offset by purchases of Latin American raw materials and foodstuffs by the Economic

Cooperation Administration. Originally the ECA purchases in Latin America were apparently budgeted at about $1,700 million for the fifteen-month period April 1948 – June 1949. How much of this amount will actually be spent during the calendar year 1948 it is impossible to tell. The purchases authorized and reported by the ECA up to August 25 were distributed as follows:

(In Millions of Dollars)

Mexico (canned beef, lead, sisal, cottonseed, linseed)	$19.6
Chile (copper, nitrate)	17.9
Venezuela (petroleum and petroleum products)	14.6
Brazil (hides, cottonseed)	4.5
Cuba (alcohol, sugar)	3.6
Peru (zinc, lead)	2.1
Uruguay (hides)	1.4
Nicaragua (sesame)	.8
Total	$64.5

Thus, it appears clear that overall dollar supplies available to Latin American countries in 1948 will be less than in 1947, and that consequently the record breaking American exports to those countries last year are a matter of the past. During the first six months of this year, our exports were at the annual rate of $3,350 million. This was about $500 million or 13 per cent less than in 1947. A further, though not precipitous, decline from this rate is indicated.

But again, these figures relate to overall totals and not to trade of particular areas. The countries benefiting from the ECA offshore purchases or from our expanding imports are not always the ones with the most serious balance of payment difficulties. Among the principal beneficiaries is Venezuela, one of the nine republics with no dollar shortage problem. During the first half of this year these countries took our goods at an annual rate of $1,300 million or about as much as in the same period last year; and, except for internal business conditions, there is no reason why their purchases should not continue at about the present level.

The remaining Republics can hardly escape a further curtailment of their purchases here even with the benefit of the ECA purchases and credits. Our exports to them during the first six months were at an annual rate of about $2,000 million, as against $2,550 million in 1947.

Toward Multilateral Trade

As the Herter Committee on Foreign Aid pointed out, it is not the purpose of our financial assistance "to make it possible for Latin America to import more goods than it can afford . . . or to maintain the artificially high level of import achieved in 1947." Nor is the object of offshore purchases to bolster up the prices of Latin American export commodities, such as coffee or sugar, in dollar markets. On the other hand, to quote the Herter Report again:

> Unless some portion of the exports to the participating countries can be financed in dollars, Latin America will clearly be unable to pay for its minimum essential requirements of goods that can be obtained only for dollars and will consequently probably attempt to direct more of its exports to dollar areas, at the expense of Europe. The United States can properly be asked to undertake such a proportion of the financing of Latin American exports to Europe as will prevent this redirection.

Hence the financing of offshore purchases should not only aid European recovery but also ease Latin America's postwar readjustments while Western Europe's purchasing power is being built up. Since the offshore purchases are not intended to help Latin America try to avoid making postwar readjustments, the ECA cannot be expected to finance exports after Europe, by reason of increasing production of sugar and similar products, no longer requires as much of certain Latin American imports. At the same time, since ECA financing is intended to meet only a temporary need, the Latin American republics will have to shift the buying of some of their essential requirements to Europe, if and when the goods become available.

The restoration of Europe's economy is even more important for Latin American republics than for us in view of their dependence upon relatively few export commodities. Normally over 10 per cent of their total production is sold in Europe. Before the war the triangular pattern of trade between Latin America, United States and Europe made it possible for some republics to use convertible exchange earned in Europe for purchases here, while other republics passed the dollars earned here to Europe. Certainly the reestablishment of these multilateral trade relationships would place our trade with Latin America on a broader, more stable basis. Progress in this direction requires greater production in Europe, and adaptation of European products to changing Latin American requirements. On the part of the Latin American republics, moderation is called for in raising tariff barriers to the flow of European products in order to protect some of their budding industries. Otherwise the bilateral trade tendencies which have been encouraged in recent trade agreements between certain European and Latin American countries are bound to continue to assert themselves.

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